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FISCAL IMPACT STATEMENT

LS 6257

BILL NUMBER: HB 1506

NOTE PREPARED: Nov 21, 2006

BILL AMENDED:

SUBJECT: Property Tax Deductions and Inheritance Taxes.

FIRST AUTHOR: Rep. Foley

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: ☒ **GENERAL**
☒ **DEDICATED**
☐ **FEDERAL**

IMPACT: State & Local

Summary of Legislation: *Trusts:* The bill provides that a trust is entitled to certain Property Tax deductions for real property owned by the trust if the property is occupied by an individual who has a beneficial interest in the trust, is considered to have a life estate in the real property, and otherwise qualifies for the deduction.

Inheritance Tax: The bill removes a provision that prevents individuals who are adopted as adults after June 30, 2004, from being considered Class A transferees for purposes of the Inheritance Tax. It increases the Class B transferee Inheritance Tax exemption amount from \$500 to \$20,000 and the Class C transferee Inheritance Tax exemption amount from \$100 to \$10,000. It also increases from \$1,000 to \$5,000 the maximum amount that may be deducted for purposes of Inheritance Tax from the value of property interests transferred by a resident decedent for the purchase of a memorial for the decedent.

Effective Date: July 1, 2007.

Summary of Net State Impact: The annual net fiscal impact to the state General Fund from Inheritance Tax changes proposed in the bill is summarized in the table below. Under the bill, Indiana Inheritance Tax revenues will decrease beginning in FY 2009. In addition, the bill is expected to increase state General Fund expenditures on county Inheritance Tax replacement beginning in FY 2010.

	FY 2009	FY 2010 and after
Inheritance Tax	(\$14.1 M - \$17.6 M)	(\$14.1 M - \$17.6 M)
Add'l. County Replacement Expenditures	0	(0.08 M - 0.1 M)
Net Increase (Decrease)	(\$14.1 M - \$17.6 M)	(\$14.2 M - \$17.7 M)

Explanation of State Expenditures: *County Inheritance Tax Replacement:* The change in the exemptions for Class B transferees and Class C transferees could potentially increase expenditures from the state General Fund for county Inheritance Tax replacement by approximately \$80,000 to \$100,000 annually beginning in FY 2010. (Note: Replacement payments are made in the fiscal year following the fiscal year in which counties experience revenue shortages.) Necessary replacement funding may vary depending on whether, and by how much, each county's base revenue differs from the amount guaranteed under current statute. (See *Explanation of Local Revenues*, below, for an explanation of county revenue loss and replacement procedures.)

The impact of extending Class A transferee status to certain adult adoptees is indeterminable. In addition, it is estimated that the increase in the memorial deduction likely would not lead to any increase in expenditures from the state General Fund for county Inheritance Tax replacement.

Explanation of State Revenues: *Trusts:* The state levies a small tax rate for the State Fair and State Forestry that applies to all assessed value (AV). If property is not a part of the tax base, the state cannot assess this tax on the property. Any decrease in the AV base resulting from additional aged, blind/disabled, and veterans deductions granted due to this bill would decrease the property tax revenue for these two funds. However, the potential revenue loss due to the bill is indeterminable.

Inheritance Tax: The bill makes three changes relating to the Inheritance Tax. The changes and potential state fiscal impact are described below.

(1) The bill extends Class A transferee status to certain adult adoptees, increasing their exemption from \$100 to \$100,000. This could potentially reduce revenue from the Inheritance Tax, but the potential reduction is indeterminable. Any impact resulting from this bill could potentially begin in FY 2009.

(2) The bill increases the Class B transferee exemption from \$500 to \$20,000 and the Class C transferee exemption from \$100 to \$10,000. The exemption changes apply to transfers from persons who die after June 30, 2007. It is estimated that the exemption increases could potentially reduce Inheritance Tax revenue by approximately \$13.7 M to \$16.9 M annually beginning in FY 2009.

(3) The bill increases the maximum allowable deduction for a decedent's memorial expenses from \$1,000 to \$5,000 for estates of decedents who die after June 30, 2007. The deduction increase could potentially reduce Inheritance Tax revenue to the state by \$350,000 to \$690,000 annually beginning in FY 2009.

Background Information: *Adult Adoptee Provisions:* Current law provides a \$100,000 exemption under the Inheritance Tax for Class A transferees - lineal descendants, lineal ancestors, stepchildren, and legally adopted children of a decedent. The latter includes an individual who was totally emancipated at the time of the adoption provided the adoption was finalized before July 1, 2004. The bill eliminates the cut-off date so that totally emancipated individuals adopted on or after July 1, 2004, would qualify for the Class A

exemption of \$100,000.

Class B and C Transferee Exemptions: The bill increases the Class B transferee exemption from \$500 to \$20,000 and the Class C transferee exemption from \$100 to \$10,000. Under current statute, Class B transferees include the sister, brother, niece, nephew, daughter-in-law, or son-in-law of a decedent. Class C transferees include the aunt or uncle of a decedent; or any other transferee not in Class A or Class B. The increase in the exemption is effective for transfers of decedents who die after June 30, 2007. Since the Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5 percent early payment discount), the initial fiscal impact of increasing the exemption would lag the change by about one year. Thus, the bulk of the initial fiscal impact would arise in FY 2009.

The estimated impact of the exemption changes is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2007 forecast (published December 14, 2005). The forecast estimates FY 2007 Inheritance Tax at \$140.0 M. The estimated revenue loss assumes that Inheritance Tax revenues would remain relatively constant after FY 2007 absent the increased exemptions. The Inheritance Tax database is comprised of about 336,000 records of transferees receiving assets from a decedent who died between July 1, 1997, and December 31, 2005. Annual sample totals suggest that Class B beneficiaries account for about 31.0% of annual Inheritance Tax revenue (about \$43.4 M of the forecast amount); and Class C beneficiaries account for about 24.3% of annual Inheritance Tax revenue (about \$34.0 M of the forecast amount). About 99.1% of total Inheritance Tax collections are from Indiana residents. Since counties retain 8% of resident Inheritance Tax, annual county collections from Class B beneficiaries are estimated to total about \$3.7 M, and from Class C beneficiaries are estimated to total about \$2.9 M. Simulations with the sample returns suggest that the exemption increase could reduce revenue from Class B beneficiaries by about 20.7% to 25.3%, and from Class C beneficiaries by about 14.0% to 17.5%. A total of 92% of resident Inheritance Tax revenue and 100% of nonresident Inheritance Tax revenue is distributed to the state General Fund.

Memorial Deduction: Under current statute, the cost of a memorial for a decedent is deductible from the taxable value of property interests transferred by a decedent to his or her transferees. Currently, the deduction is limited to \$1,000. The increase to \$5,000 applies to estates of decedents who die after June 30, 2007. The estimated impact of the memorial deduction increase assumes that an average of 9,400 estates file Inheritance Tax returns annually and that the average expenditure on a memorial ranges from about \$2,000 to \$3,000. Based on this range, estates would, on average, be claiming an additional \$1,000 to \$2,000 under this deduction. The fiscal impact is also based on a 4.3% average Inheritance Tax rate estimated for Class A, B, and C transferees. It also accounts for tax-exempt transfers to surviving spouses and charities estimated to represent about 7.5% of transferees.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Trusts:* The bill could potentially lead to additional aged, blind/disabled, and veterans deductions being granted. However, the total amount of these additional deductions is indeterminable. The additional deductions would serve to shift part of the property tax burden from the taxpayers receiving the deduction to all taxpayers in the form of an increased tax rate.

County Inheritance Tax: The bill could potentially result in the net impact to counties summarized in the table below.

	FY 2009	FY 2010 and after
Inheritance Tax	(\$1.2 M - \$1.6 M)	(\$1.2 M - \$1.6 M)
Add'l. County Replacement Payments	0	0.08 M - 0.1 M
Net Increase (Decrease)	(\$1.2 M - \$1.6 M)	(\$1.1 M - \$1.5 M)

Background Information: Trusts: The bill provides that a trust is entitled to the aged, blind/disabled, and veterans property tax deductions for real property it owns, provided the property is occupied by an individual and the county auditor determines that the individual: (1) has a beneficial interest in the trust; (2) otherwise qualifies for the deductions; and (3) would be considered the owner of the property under the property tax law.

County Inheritance Tax: Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents, and are guaranteed a statutorily determined amount from the Inheritance Tax under the replacement provision established by P.L. 254-1997. This legislation increased the Class A exemption to \$100,000 effective July 1, 1997, and required the state to annually transfer money from the state General Fund to counties to replace county Inheritance Tax revenue lost due to the exemption increase. The replacement provision guarantees that each county receive an amount of Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997, excluding the highest year and lowest year from the computation. The total annual guarantee to counties is approximately \$7.4 M, with replacement payments averaging about \$208,000 since FY 2000. (Note: Replacement payments are made in the fiscal year following the fiscal year in which counties experience revenue shortages.)

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue.

Local Agencies Affected: Counties, cities, and towns; County Auditors.

Information Sources: State Revenue Forecast (December 14, 2005). OFMA Inheritance Tax database. Department of State Revenue, *Quarterly Inheritance Tax Reports*. Tony Caldwell, President, Indiana Affiliate of Monument Builders of America/Owner, Caldwell Monument Company, Kokomo, (765) 459-8480. Wisconsin Department of Agriculture, Trade, and Consumer Protection, *Planning a Funeral*, (608) 224-5058.

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